Commerce News
UNITED STATES DEPARTMENT OF COMMERCE
Economics and Statistics Administration • Office of the Under Secretary
Washington, D.C. • (202) 482-3727 • www.esa.doc.gov

For immediate release
July 27, 2001

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on Advance Gross Domestic Product in the Second Quarter

Overview

The U.S. economy has grown at a modest pace for the fourth consecutive quarter, following very rapid growth during 1999 and the first half of 2000.

The current slowdown differs from the pattern of the last five recessions in several important and interesting ways. In the four quarters before the recent slowdown, growth in real GDP was much stronger and inflation was much lower than in the year immediately preceding any of the last five recessions. Specifically, real GDP rose at a very strong 5.2-percent pace in the four quarters ending in the second quarter of 2000. But growth averaged only 2.6 percent in the year immediately preceding the last five recessions, and the strongest gain was 4.3 percent. In contrast, inflation, as measured by the consumer price index, rose only 3.3 percent in the four quarters ending in the second quarter of last year but averaged 9 percent in the year before the last five recessions.

Another distinctive feature of the current period is that a sizeable and timely tax cut has been put in place, with distribution of almost $40 billion in checks already begun.

The combination of very strong growth and modest inflation in the year before the current slowdown resulted from unusually rapid growth in productivity and little pressure on manufacturing capacity. Since inflationary pressures were low, the Federal Reserve was able to act quickly and forcefully. This difference led to a unique feature of the current slowdown. Household purchases of big-ticket items – new motor vehicles and houses – have remained at high levels and have contributed very little to the slower growth in overall GDP. During recessions, declines in these purchases contributed significantly to changes in overall growth.

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Business investment in equipment and software, however, has contributed more to the overall change in growth in the current slowdown than in any of the five recessions. In addition, consumption expenditures, other than motor vehicles, have contributed more to the current slowdown than was the case, on average, in the recessions. The contribution of inventory investment in the current slowdown matches the average in the recessions.

Second-Quarter Developments

Real gross domestic product rose at a 0.7-percent annual rate in the second quarter, slightly below the modest gains of the average 1.5 percent in the previous three quarters. Taken together, growth during the past four quarters has been the slowest since the 1990-91 recession.

The key price index for gross domestic purchases rose 1.5 percent at an annual rate in the past quarter, down from the 2.7 percent first-quarter pace. Core prices – prices excluding food and energy – rose 1.1 percent at an annual rate in the second quarter, following a 2.3 percent increase in the first quarter.

Consumer spending rose 2.1 percent at an annual rate, its fifth moderate gain in a row though about 3 percentage points slower than the vigorous pace that prevailed from 1998 through early 2000. Spending on services picked up after slowing in the first quarter, while spending on goods slowed, as motor vehicle purchases rose less rapidly than in the first quarter.

Growth in real disposable personal income rose at a moderate 2.5 percent annual rate in the past quarter, about the same as in the first quarter. During the 1997-2000 period, growth in disposable income averaged nearly 4 percent. Tax rebates will bolster after-tax income in the third and fourth quarters. Measures of consumer attitudes have improved during the last three months, remaining at historically high levels even though they have dropped more than 15 percent below their record levels of early 2000.

Residential construction improved for a second quarter in a row, as favorable credit conditions encouraged single-family home building.

Business investment in equipment and software dropped sharply in the second quarter, marking its third consecutive decline. Weakness was widespread, with a particularly large decline in information technology. Business investment in structures fell in the second quarter after six quarters of strong gains, as lower operating rates and higher commercial vacancy rates appear to be taking their toll.

Government consumption and investment rose as federal government spending increased modestly, while state and local government spending recorded a large increase.

Business inventories changed little after declining in the first quarter. As a result, inventory investment contributed 0.03 percentage point to growth in overall GDP, representing a significant shift from the subtraction of 2.6 percentage points from growth in the first quarter.

Annual Revisions

As it does each year, the Bureau of Economic Analysis revised the national income and product accounts for the last three years to incorporate updated source data and changes in methodology.

Average growth in real GDP from the fourth quarter of 1997 to the fourth quarter of 2000 was revised down from 4.3 percent from 4.0 percent. Investment in equipment and software, consumer expenditures, and nonresidential structures accounted for most of the downward revision. Growth during 2000 in real GDP was revised down from 3.4 percent to 2.8 percent. The major price indexes were changed very little, if at all.

The downward revision in output growth implies that productivity growth will be revised downward by the Labor Department in their next release.

On the income side of the national accounts, corporate profits were revised down while wages and salaries were revised up. With less consumer spending and higher consumer income, the personal saving rate not only was revised up during the1998-2000 period, but also remained above zero.

The Near-term Outlook

At mid-year, the U.S. economy is experiencing a variety of crosscurrents. The weakness in business investment and the slowdown in growth in foreign economies are holding down overall growth. But I am hopeful that other influences are beginning to steer the economy in the direction of a stronger performance. Lower interest rates have supported a high level of housing activity. The drop in mortgage rates also has encouraged a jump in refinancing that may free up equity or income, as will the recent drop in energy prices. Most importantly, the tax cut could not have come at a better time and should support consumer spending over coming quarters. Moreover, as Chairman Greenspan noted, business investment ultimately depends on the strength of consumer demand. Consequently, the tax cut is providing a stimulus to the economy in a very important and fundamental way.